The Manufacturers Hanover
Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

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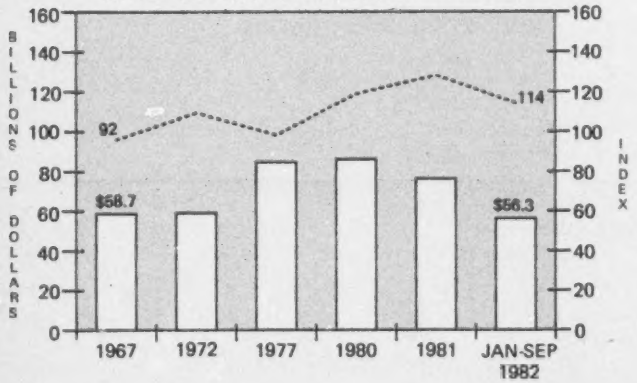
It's A Long Convalescence . . .

Amid ever-swirling rumors of imminent discount rate cuts, monetarism abandoned and recovery found, one of the most welcome financial developments occurring this year was the strong surge in equities prices. Until last week neither soaring levels of business bankruptcies nor swelling numbers of unemployed deterred the optimism of analysts, traders and investors alike. Notwithstanding last week's decline in stock prices, it would seem as though the U.S. economy will continue to expand over the near term—albeit weakly.

Any expansion, however mild, will come none-too-soon for hard-hit corporate America. For, simply put, one factor which is not driving equities prices higher is recent trends in corporate profits. According to preliminary estimates by this Bank, before-tax profits remained virtually unchanged in the third quarter, rising a slight $3 billion quarter-over-quarter, or just about two per cent, to a

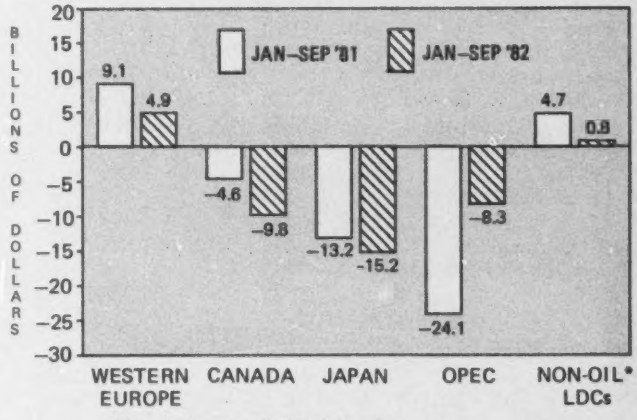
CHART I
REAL AFTER-TAX CORPORATE PROFITS (BAR) VS. STANDARD & POOR'S COMPOSITE OF 500 STOCKS (DOT)



seasonally adjusted $175 billion annual rate. This implies that pre-tax profits in the third quarter were about 25 per cent, or nearly $60 billion, below year-ago levels. With only two exceptions, this would be the largest percentage plunge in corporate profits during any four-quarter period in the postwar era. The largest came just six months earlier when, during the year ending March, 1982, they fell by 32 per cent (or about $80 billion). What is more, after-tax earnings did not perform any better. During the July-September period, they rose by only $2 billion quarter-over-quarter, to a seasonally adjusted $118 billion annual rate.

About the best that can be said of these numbers is that the long profits plunge may have finally bottomed out. If so, two factors in particular appear

CHART II
U.S. MERCHANDISE TRADE BALANCE WITH SELECTED COUNTRIES
(F.A.S. EXPORTS/C.I.F. IMPORTS BASIS)



*Data for January through July only.

principally responsible. For one, the sharp drop in inflation-driven, inventory profits has almost ceased. Whereas these profits had accounted for as much as 30 per cent of after-tax earnings only two years ago—swelling reported earnings—their rapid evaporation, in the emerging climate of disinflation, has had just the opposite effect: namely, exaggerating the profits slide. Last quarter for example, with inventories pared and inflation rates subsiding, inventory profits ran at an approximately $10 billion seasonally adjusted annual rate, almost unchanged from quarter-earlier levels—but now comprising less than nine per cent of after-tax profits. This was $13 billion below the level of inventory profits registered during the third quarter of 1981, a drop which alone accounted for almost 50 per cent of the decline in after-tax earnings since then.

Although halting the free-fall in inventory profits may help stabilize earnings size, it does little for

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earnings quality. But recent trends in unit labor costs do—and they point to a brightening profits scene. With average weekly earnings dipping and productivity rising, unit labor costs in manufacturing declined slightly in the third quarter—only the second time in seven years. They fell at a 0.6 per cent seasonally adjusted annual rate in the third quarter, a substantial turnaround when compared with third quarter, 1981 results. At that time, they shot up at a seven per cent seasonally adjusted annual rate.

. . . For Ailing Corporate Finances . . .

While the long earnings slide may be coming to an end, corporate financial health is still a long way off. In recent years, as corporate earnings growth slowed and cash flows became evermore severely squeezed, business dependence on debt, especially high-cost, short-term debt, expanded rapidly—with all-too-predictable consequences for most traditional indicators of corporate liquidity. One measure, the ratio of interest expense to net cash flow may hit 33 per cent this year; it was only 20 per cent in 1976. Another, the ratio of short-term debt to total liabilities currently stands just a shade below 50 per cent, well above the 40 per cent level prevailing six years ago. So, too, such ratios as current assets to current liabilities, debt to equity and dividends to after-tax earnings have all deteriorated sharply, and are unlikely to turn around any time soon.

Thus, for many corporations, interest costs will

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 10/20/82	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	142.041	+ 2.305	+ 8.341
Loans to Depository Inst.	.515	+ .155	– .741
Float	2.770	+ .431	– .767
Total Reserve Bank Credit	155.776	+ 3.167	+ 7.145
Treasury Deposits with Federal Reserve Banks	2.858	+ .039	– .885
Currency Outside Banks	134.282	+ 1.264	+ 9.546
Member Bank Reserves:			
Required	40.972	+ 2.089	– .202
Excess (Deficiency)	.285	– .246	– .002
Total Reserves Held	41.257	+ 1.843	– .204
Net Borrowed Reserves	.145	+ .386	– .669
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	100.219	– .720	+ 9.729

Monetary Aggregates†		% Change Since Three Months Ago*	% Change Since Year Ago
M1	467.7	+ 13.2‡	+ 7.5‡
M2 (September '82)	1,954.5	+ 9.8	+ 9.9
M3 (September '82)	2,362.5	+ 11.6	+ 10.5
L (June '82)	2,797.8	+ 12.0	+ 11.6

†Seasonally adjusted. *Seasonally adjusted annual rate. ‡Four-week moving average.

New York Money Market

Offering Rates 10/29/82	3 Months	6 Months	1 Year
‡U.S. Treasury Bills	7.83%	8.32%	8.46%
* Federal Agencies	7.80	8.65	10.30
* Project Notes—Taxfree (46% Taxable Equivalent)	7.69	8.06	10.00
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market—Prime	9.05	9.35	10.25

‡Finance Company Paper—Prime		‡* Bankers' Acceptances	
5- 14 days	8.75%	Nov.	8.80%
15- 29 days	8.75	Dec.	8.80
30- 59 days	8.63	Jan.	8.90
60- 89 days	8.63	Feb.	8.90
90-179 days	8.50	Mar.	9.00
180-239 days	8.50	Apr.	8.95
240-270 days	8.50		

‡Industrial Paper—Prime		†Federal Funds Effective Rate	9.45%
30- 89 days	8.63%		
90-120 days	8.63		

‡Discount basis. * Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'82	$ 3,091	$ 3,045	$ 2,981
Gross National Product (1972 Dollars)*	3rd Q'82	$ 1,481	$ 1,478	$ 1,510
Percent Change, Annual Rate	3rd Q'82	0.8	2.1	2.2
Change in Consumer Prices (all urban consumers)*	Sep '82n	2.4%	3.6%	13.2%
Change in Producer Prices*	Sep '82	– 1.2%	7.2%	2.4%
Civilian Employment (Thousands of Persons)†	Sep '82	99,720	99,839	100,258
Unemployment as % of Civilian Labor Force†	Sep '82	10.1%	9.8%	7.6%
Personal Income*	Sep '82	$ 2,605	$ 2,597	$ 2,479
Leading Indicators Composite Index (1967=100)†	Sep '82n	130.4	129.7	130.7
Industrial Production Index (1967=100) †	Sep '82	137.3	138.1	151.6
Net Change in Consumer Installment Credit†	Aug '82	$ 0.07	$ 0.57	$ 2.43
U.S. Merchandise Trade Balance †	Sep '82n	–$ 4.19	–$ 7.08	–$ 2.77
Plant and Equipment Expenditures*	4th Q'82	$324.47(a)	$328.04(a)	$327.83
Private Housing Starts (Thousands of Units)*	Sep '82	1,146	1,002	899
New Construction Expenditures*	Aug '82	$ 232.3	$ 228.7	$ 235.9
Total Business Inventories†	Aug '82	$ 515.6	$ 513.4	$ 510.1
Total Business Sales†	Aug '82	$ 339.1	$ 344.6	$ 354.5

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. a-Anticipated.

continue to absorb a good-sized chunk of internally-generated funds and most will remain extremely vulnerable to abrupt changes in short-term credit costs and availability. To be sure, a growing number are attempting to lessen this vulnerability, funding large amounts of short-term debt in the bond markets. But while new corporate bond issuance has surged to about $5 billion monthly over the last four months (compared with less than $2 billion monthly during the first half of 1982), the task ahead remains enormous. If, for example, the ratio of short-term to total liabilities is to be again reduced to 40 per cent, the current level of corporate bond offerings must be maintained for at least the next 20 months—and all of the proceeds used to retire $100 billion of existing short-term debt!

Until such improvements are underway and corporate profits growth accelerates, the permanence of the equities price rally may be as fleeting as brightly-colored autumn leaves. After all, although the Standard and Poor's Composite 500 Stock Index is 24 per cent higher now than in 1967, inflation-adjusted, after-tax earnings are actually lower today than in 1967 (see Chart I).

. . . And Export Sales . . .

Judging by the latest export figures it doesn't appear that overseas sales will be a major contributor to corporate profits in the near future. Not only are the prospects for world trade dismal for the rest of 1982 and only slightly better in 1983, but the global recession and the strong dollar have dealt the U.S.

Short Term Paper Outstanding

(Millions of Dollars)

	Latest Week	Change Since Week Ago	Change Since Year Ago
Negotiable Time CD's Weekly Reporting Banks			
Nationwide (10/13/82)	148,414	+ 359	+18,704
New York City (10/13/82)	37,500	+ 378	+ 5,092
Commercial Paper (10/13/82)	173,610	– 20	+10,931

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/13/82)	218,605	– 1,420	+29,942
New York City (10/13/82)	62,514	– 171	+ 7,608

Total Loans Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (10/13/82)	503,632	+ 923	+44,716
New York City (10/13/82)	122,132	+ 2,066	+11,578

Financial Markets

	Friday 10/29/82	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.10%	+ .20	– 5.15
180-Day Bills†	8.80	+ .20	– 5.05
Longest Bills†	9.15	– .05	– 5.20
Recent Issues:			
9 3/4s 10/31/84 (When Issued)	7.79	– 2.19	
12 1/4s 9/30/86	10.41	– .20	
13 3/4s 5/15/92	11.05	– .29	
14s 11/15/11	10.87	– .14	
Municipals:			
Bond Buyer–20 Bond Index* (10/28/82)	10.05%	+ .36	– 2.94
Blue List Total ($ Million)	$1,323	– $ 97	+ $ 502
30-Day Visible Supply ($ Million)	$4,279	– $ 59	+ $2,558
Total	$5,602	– $156	+ $3,060
Corporates:			
Moody's Aa Composite (10/28/82)	12.85%	+ .06	– 3.10
30-Day Visible Supply ($ Million) ‡	$1,420	+ $160	NA
Stocks:			
Dow-Jones Averages:			
Industrials	991.81	– 39.65	+ 139.26
Transportation	420.19	– 19.18	+ 44.59
Utilities	119.14	– 2.40	+ 12.29
65 Stocks	389.03	– 15.15	+ 48.40
Standard and Poor's 500 Stocks	133.71	– 5.12	+ 11.82
N.Y.S.E. Composite Index	76.95	– 2.73	+ 6.31
N.Y.S.E. Avg. Daily Vol. for Week (000's)	83,274	–18,266	+ 35,428

* 46% Taxable equivalent 18.61%.
‡Series redefined: Historical data not available.
† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 10/29/82	Week Ago
Overnight	9.63%	9.50%
1 month	9.63	9.56
3 month	9.94	9.75
6 month	10.19	10.00
1 year	10.50	10.38
EURODOLLAR BONDS Average Yield		
Medium Term (5 to 7 yrs.)	12.75%	12.70%
Long Term (7 to 15 yrs.)	12.70	12.65

FOREIGN EXCHANGE SPOT RATES

New York Opening (10/29/82)	U.S. $ Equivalent	Currency Per U.S. $
Belgium	.02019	49.54
Canada	.8156	1.2261
Denmark	.1112	8.9955
France	.1380	7.2485
Germany	.3900	2.5640
Italy	.0006793	1472.10
Japan	.003603	277.53
Mexico	.009346	107.00
Netherlands	.3592	2.7840
Switzerland	.4519	2.2128
U.K.	1.6725	.5979

trade balance a severe blow. In September the U.S. merchandise trade deficit was a still hefty $4.2 billion (fas exports/cif imports basis) after a record $7.1 billion deficit in August. The reduction in the monthly deficit was due to a large decline in imports while exports held virtually steady. In September, exports fell less than one per cent from the previous month's level while imports were down over 12 per cent (after rising some 20 per cent in the prior month). But over one-third of the drop in last month's imports was due to a sharp plunge in petroleum purchases abroad which were down 19.3 per cent in value and 17.5 per cent in volume terms from the previous month. Wide monthly fluctuations in oil imports in the last two years have made monthly import data particularly volatile.

In spite of the wide monthly variations in the merchandise trade data, it is apparent that there has been a general deterioration in the U.S. trade position this year (see Chart II). During the first nine months of 1982, the U.S. generated a $29.7 billion merchandise trade deficit compared with a $28.6 billion deficit for the same period in 1981. A closer look at the details behind these figures, however, indicates that the weakness is widespread. At a seasonally adjusted annual rate, exports are running about seven per cent below 1981 and imports have fallen by about six per cent. In those areas where the United States usually runs trade surpluses, such as Western Europe and the non-oil developing countries (LDCs), the surpluses for the first nine months of this year were substantially below the levels for the same period last year. In those areas where the U.S. usually runs a deficit on trade, the deficits for the first three quarters of 1982 were greater than for the first three quarters in 1981—except for the OPEC nations, where the steep decline in oil imports into the U.S. has reduced the trade imbalance. Petroleum imports for the first eight months of this year were down 23.5 per cent in value terms and 15.5 per cent in volume terms below the same period in 1981.

. . . Will Be No Panacea

World trade has been depressed for the past two years as a result of the global recession. But beyond the general weakness of the U.S. trade position due to the global economic environment are the perverse trade effects of the strong dollar. Exports are adversely affected because the strong dollar reduces price competitiveness abroad. What is less often mentioned, however, is the fact that the strong dollar not only stimulates imports (which are cheaper in dollar terms), but also that competition in the U.S. domestic market increases. This is because foreign competitors can either underprice those American firms in the U.S. market or they can generate a higher profit which strengthens the balance sheets of the foreign firms at the expense of their U.S. competitors. Since an American company's domestic market is usually its principal, most stable and most profitable market, these effects of the strong dollar can be particularly damaging. ■

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